

REVISED DISCUSSION FOR ISSUE PAPER

Definition of Consumable Property for Purposes of the Manufacturer's Exemption (Regulation 1525.2)

I. Issue

Should Regulation 1525.2, *Manufacturing Equipment*, be amended to provide an option to refute the provisions classifying certain items as consumables that do not qualify for the partial tax exemption?

II. Staff Recommendation

Staff recommends that Regulation 1525.2 not be amended.

III. Other Alternative(s) Considered

Ernst & Young has proposed amendments to 1525.2 (c)(9)(B) and (c)(10)(B) that would allow taxpayers to submit evidence to overcome presumptions that certain tangible personal property is a consumable item and not subject to the partial tax exemption. This evidence could overcome the presumptions that consumables consist of property that the taxpayer either treats as having a normal useful life of less than one year for state income or franchise tax purposes, or which was acquired by the taxpayer at a unit cost of \$250 or less.

IV. Background

Partial Exemption for Manufacturing Equipment

Section 6377 of the Revenue and Taxation Code was added by Statutes of 1993, Chapter 881, in effect October 6, 1993, but operative January 1, 1994, and was later amended by Statutes of 1994, 1995, and 1996. Section 6377 provides an exemption from the state portion of the sales and use tax on purchases by “qualified persons” of tangible personal property for use:

1. In manufacturing, processing, refining, fabricating, or recycling;
2. In research and development activities described in Section 174 of the Internal Revenue Code;
3. To maintain, repair, measure, or test any property described in 1 or 2 above; or
4. By a construction contractor purchasing the property either as an agent of a qualified person or for the contractor’s own account and subsequent resale to a qualified person for use in the performance of a construction contract for the qualified person who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with the manufacturing process.

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Throughout 1994, the partial exemption was equal to six percent. Effective January 1, 1995, the exemption was reduced to five percent. Accordingly, any sale after that date that qualifies for the partial exemption remains subject to all additional taxes imposed above five percent (at least 2 ¼ percent tax, plus any transaction tax imposed in the relevant district). The exemption is not automatic since a qualified person may alternatively claim a manufacturer's investment credit (MIC) of six percent of the purchase price on their state income tax return for such purchases of tangible personal property. The sales and use tax exemption is intended to provide an immediate benefit to start-up businesses that would normally not be able to use an income tax credit. It is frequently the case that new businesses lack a sufficient amount of taxable income against which the MIC can be claimed.

Regulation 1525.2, *Manufacturing Equipment*, which interprets and explains RTC section 6377, first became effective on August 18, 1995. Subsequent amendments became effective December 7, 1997 and April 3, 1999. Proposed amendments adopted by the Board on April 6, 2000 are included in the copy of Regulation 1525.2 reproduced as **Exhibit 1**. It is anticipated these latest amendments will become effective by the end of July 2000.

As of April 30, 2000, 1,619 applications for Manufacturer's Exemption certificates have been approved since the inception of the program, and 627 applications denied as not meeting the requirements of the program.

Consumable Property

Regulation 1525.2 (c)(10)(B) provides that "tangible personal property" includes:

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall have a useful life of less than one year for purposes of this regulation.

As provided by Regulation 1525.2 (c)(9)(B), "tangible personal property" does not include:

(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E) [fuels used or consumed in the manufacturing process]. Tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation.

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Proposed Amendments Regarding the Definition of Consumable Property

A number of revisions to Regulation 1525.2 were proposed by interested parties in 1999, and were submitted to the Business Taxes Committee on November 17, 1999. A proposal to amend the definition of consumable property was among those submitted. The Committee approved staff's recommendation to make no revisions to Regulation 1525.2 concerning consumable property, but suggested that further study of this area may be warranted. This issue has been scheduled for discussion once again at the August 8, 2000 Business Taxes Committee meeting.

In his July 21, 1999 correspondence, Mr. Glenn Bystrom of Ernst & Young (hereafter "Ernst & Young") proposed language to allow a qualified purchaser the option to refute the classification of certain items as consumable items that do not qualify for the partial exemption from tax. In their September 20, 1999 letter, Ernst & Young stated,

"While we agree [the current] rules do provide a bright line test, our suggested language recognizes that situations occur where items with a useful life of more than one year are expensed for financial and tax reporting purposes. It is not practical to account for all property acquired as an asset even if the useful life may exceed one year. For this reason our proposal retains the general rule regarding the income tax treatment of the property, yet we believe it is appropriate to allow taxpayers the opportunity to rebut this presumption by submitting evidence to establish a useful life of more than one year. We also suggest that the \$250 threshold be removed from the regulation. The amount is arbitrary and without any statutory support. As with other monetary thresholds, the problem of ongoing adjustments to account for inflation occurs."

On October 29, 1999, Mr. Eric Miethke of Nielsen, Merksamer, Parrinello, Mueller, representing PriceCostco (hereafter, "PriceCostco"), conveyed PriceCostco's opposition to Ernst & Young's proposal to eliminate the \$250 threshold. Their opinion was that this bright line de minimus test is fair, and helps prevent retailers from having to determine whether the tangible personal property they sell qualifies for the partial exemption at the point of sale. Alternately, if the \$250 threshold is eliminated, PriceCostco proposed that retailers be held harmless from their acceptance of any certificate, without having to demonstrate that the certificate was accepted in good faith.

Interested Parties Meeting, April 25, 2000

At the meeting with interested parties on April 25, 2000, Ernst & Young submitted an amended proposal. They stated they no longer recommend that the \$250 threshold be removed from the regulation. Rather, they have now proposed amendments to 1525.2 (c)(9)(B) and (c)(10)(B) that would allow taxpayers to submit evidence to overcome presumptions that certain tangible personal property is a consumable item and not subject to the partial tax exemption. This evidence could overcome the presumptions that consumables consist of property that the

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taxpayer either treats as having a normal useful life of less than one year for state income or franchise tax purposes, or which was acquired by the taxpayer at a unit cost of \$250 or less.

V. Discussion

The manufacturer's exemption is not directly comparable to other exemptions. This partial exemption is only available to qualified persons for a defined period of time. Retailers who accept a partial exemption certificate have the burden of reporting and paying the remaining tax liability from their sale, and face potential liability for the entire amount of tax when they fail to accept a partial exemption certificate in good faith. Whether a retailer accepts a partial exemption certificate in good faith largely depends on the retailer's knowledge of whether the property sold qualifies for the exemption itself.

During the first public hearings for proposed new Regulation 1525.2, PriceCostco expressed concerns about discerning the appropriateness of accepting an exemption certificate from their customers for specific hardware and small equipment items. The Board incorporated the \$250 threshold to address these very concerns. PriceCostco recently expressed concerns about Board auditors questioning their good faith in accepting exemption certificates if the \$250 guideline were to be removed.

Ernst & Young's current proposal is attached as **Exhibit 2**. Ernst & Young state their belief that the existing requirement in the regulation that an item must be capitalized for income tax purposes is not supported by the statute. Their proposal to incorporate a rebuttable presumption concerning property treated as having a normal useful life of less than one year for state income tax purposes, recognizes that equipment, repair, and replacement parts that do not meet the capitalization criteria for state income tax purposes or financial accounting purposes frequently have a useful life of more than one year. They note that it is often not practical for a manufacturer to account for all property acquired as an asset, even if the useful life may exceed one year:

Many large taxpayers have a very material threshold for the capitalization of tangible personal property. It is not uncommon to set the threshold at an amount of \$3,000 or more. The cost of accounting for an asset for the life of the equipment can easily exceed a threshold as low as \$250. An asset that is capitalized must be "tagged," tracked, counted in annual inventories, depreciated on the books, and ultimately disposed. Our proposal recognizes the economic reality that large companies face.

They further point out an apparent conflict between the income tax rule for capitalization of an item and the rule established in Regulation 1525.2: "The federal regulation allows for capitalization of an item if the property 'arrest deterioration and appreciably prolong the life.' It does not place as a requirement that the item must have a useful life of less than one year to be expensed for income tax purposes in the year of acquisition. It rather focuses on whether the repair parts materially add value to the property or appreciably prolong its life, or just maintain an ordinary efficient operating condition."

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Staff believes the current guidelines for defining tangible personal property with a normal useful life of less than one year are fair and clear. There can be no dispute about the nature of the property for purposes of the manufacturer's exemption if the property had a cost of less than \$250. Similarly, whether or not equipment is capitalized or expensed for state income or franchise tax purposes can be easily discerned. The lack of ambiguity provided by these rules is best evidenced by the Board's experience in the audit program and in appeals of audit determinations. During fiscal year 1998-99 (the latest period of available data), there were only four instances of audit deficiencies identified to the manufacturer's exemption, totaling \$318,187. Appeals related to this exemption are estimated to average at most five to six per year, and the majority relate to the time limit on filing for the exemption, not disputes about qualified equipment. *(Note – the audit and appeals information cited does not include pending cases that may currently be in the process of audit, petition or appeal.)*

In staff's view, the result of adopting a rebuttable presumption regarding the rules defining tangible personal property with a normal useful of less than one year, would be to abandon objective guidelines that are easily understood by taxpayers, effectively replacing these guidelines with uncertainty and subjectivity. The nature of any piece of equipment and supply or repair item purchased could become a matter of dispute, leading to more complex and contentious audits and a greater number of appeals. Staff further anticipates an increase in the number of hearings before the Board with respect to these issues.

VI. Summary

Regulatory language proposed by Ernst & Young is included in **Exhibit 3**, referenced as "Industry 1 (Manufacturers)," and PriceCostco's position is represented as "Industry 2 (Retailers)."

Prepared by the Program Planning Division, Sales and Use Tax Department

Current as of May 26, 2000

1525.2 RDP.doc

Regulation 1525.2 Manufacturing Equipment

(a) Partial Exemption for Property Purchased for Use in the Manufacturing Process. Section 6377 of the Revenue and Taxation Code provides a partial exemption from sales and use tax for certain properties described in this regulation. For the period commencing on January 1, 1994, and ending on December 31, 1994, the partial exemption applies to the taxes imposed by the state (6%), but does not apply to the taxes imposed by counties, cities, and districts pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200, et seq.) or the Transactions and Use Tax Law (Rev. & Tax. Code §§ 7251, et seq.). Commencing on January 1, 1995, the partial exemption applies to the taxes imposed by sections 6051, 6051.3, 6201, and 6201.3 of the Revenue and Taxation Code (5%), but does not apply to the taxes imposed pursuant to sections 6051.2 and 6201.2 of the Revenue and Taxation Code, the Bradley-Burns Uniform Local Sales and Use Tax Law, the Transactions and Use Tax Law, or section 35 of article XIII of the California Constitution.

Subject to the limitations set forth above, this partial exemption applies to gross receipts from the sale, storage, use, or other consumption in this state of the following items:

(1) Tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point that raw materials are received by the qualified person and introduced into the process and ending at the point at which the property has been altered to its completed form, including packaging, if required. For purposes of this regulation:

(A) Raw materials will be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing activities are conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing activities are conducted, however, will not be considered to have been introduced into the process for purposes of this regulation.

(B) For purposes of this regulation, the term "packaging" includes only that packaging necessary to prepare the goods for delivery to and placement in the qualified person's finished goods inventory, or to prepare the goods so that they are suitable for delivery to and placement in finished goods inventory. Any additional packaging, such as that packaging necessary to consolidate the goods prior to shipping or to protect them during transportation, shall not be considered to be "packaging" for purposes of this regulation.

(2) Tangible personal property purchased for use by a qualified person to be used primarily in research and development as defined in subsection (c)(8).

(3) Tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any property described in subsections (a)(1) or (a)(2).

(4) Tangible personal property purchased for use by a contractor purchasing that property either as an agent of a qualified person or for the contractor's own account and subsequent resale to a qualified person for use in the performance of a construction contract for the qualified person

who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with the manufacturing process.

(b) Property Used Primarily in Administration, General Management, or Marketing. Notwithstanding any other provision of this regulation, this partial exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing. For purposes of this subsection:

(1) Tangible personal property is used primarily in administration, general management, or marketing when it is used 50 percent or more of the time in one or more of those activities.

(2) Tangible personal property used primarily to clean and maintain the factory floor of a manufacturing facility is used primarily in a stage of the manufacturing of property and is not used primarily in administration, general management, or marketing.

(3) Fire safety equipment that is tangible personal property and that is used primarily at and in connection with the factory floor of a manufacturing facility is used primarily in a stage of the manufacturing of property and is not used primarily in administration, general management, or marketing.

(c) Definitions. For purposes of this regulation:

(1) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property. For purposes of this regulation, "greater functionality" means that the tangible personal property has been improved so that it can perform new or different functions than the original property. Manufacturing includes logging, that is, the felling of timber, but does not include tree farming. Manufacturing does not include crop harvesting. Provided that the activity constitutes a "sale" as that term is used in subdivision (b) of section 6006 of the Revenue and Taxation Code, the tangible personal property need not be owned by the qualified person in order for the activity to qualify as manufacturing for purposes of this regulation.

(3) "Primarily" means that the tangible personal property is used 50 percent or more of the time in the designated activity or activities.

(4) "Process" means the period beginning at the point at which any raw materials are received by the qualified person and are introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the

manufacturing, processing, refining, fabricating, or recycling activity of the qualified person has altered tangible personal property to its completed form including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified person's manufacturing, process, refining, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified person's manufacturing, processing, refining, fabricating, or recycling activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(5) "Processing" means the physical application of materials and labor to modify or change the characteristics of property.

(6) "Qualified person" means any person that satisfies the requirements of both subsections (c)(6)(A) and (c)(6)(B) below with regard to the trade or business in which the property will be placed into service in the use qualifying the property for this partial exemption:

(A) A "qualified person" must have first commenced trade or business activities in a new trade or business in this state on or after January 1, 1994. For purposes of this subsection, the term "activities" means trade or business activities. In determining whether or not a person is qualified within the meaning of this subsection, the following rules apply:

1. The term "trade or business activities" does not mean the mere formation or organization of a corporation or other business entity that is intended to conduct a trade or business. Instead, a corporation or business entity first conducts activities when it first starts or commences the trade or business for which it was organized. The acquisition of operating assets that are necessary to the type of business contemplated, however, will constitute commencing activities. The term "operating assets" as used in this subsection means assets that are in a state of readiness to be placed in service within a reasonable time period following their acquisition.

2. Notwithstanding any other provision of this subsection, a person will not be considered to have first commenced activities in a new trade or business in this state on or after January 1, 1994, if, at any time within the 36 months preceding that date, that person, or any related person, was required to have secured a seller's permit under section 6066 of the Revenue and Taxation Code for that trade or business, or any other trade or business classified under the same division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition (the "Manual"). For purposes of this regulation, the term "division" means a division as that term is used in the Manual.

3. A trade or business is not a new trade or business in this state if, within the 36 months preceding the date that activities were first commenced in that trade or business in this state, either the person claiming the partial exemption, or any related person, had conducted any activities in this state in any trade or business classified under the same division of the Manual as that trade or business.

4. Where a person, or any related person, is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (a "prior trade or business activity"), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new trade or business if the additional trade or business activity is classified under a different division of the Manual than are any of the person's (or any related person's) current or prior trade or business activities in this state within the preceding 36 months.

5. Where a person, including all related persons, is engaged in trade or business activities wholly outside of this state and that person first commences doing business in this state (within the meaning of section 23101 of the Revenue and Taxation Code) after December 31, 1993 (other than by purchase or other acquisition described in subsection (c)(6)(A)6.), the newly commenced trade or business activity in this state shall be treated as a new trade or business for purposes of this subsection.

6. On or after January 1, 1995, notwithstanding anything else set forth in this subsection, in any case where a person purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of the entity) that is doing business in this state (within the meaning of section 23101 of the Revenue and Taxation Code), the trade or business thereafter conducted by that person (or any related person) shall not be treated as a new trade or business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by that person (or any related person) in the conduct of his or her trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the person (or any related person) being used in the same trade or business both within and without this state. For purposes of this subsection only:

a. The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the month following the quarterly period in which the person (or any related person) first uses any of the acquired trade or business assets in his or her business activity.

b. Any acquired assets that constitute property described in section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in section 1221(1) of the Internal Revenue Code in the hands of the acquiring person (or any related person).

c. The trade or business conducted in this state by the acquiring person after the asset acquisition date shall be considered to be the same as an out-of-state trade or business conducted or previously conducted by the acquiring person (or any related person) only if the trade or business activities of both companies are or would be classified in the same division of the Manual.

d. An acquired trade or business will not be considered to have been acquired as an existing trade or business for purposes of this subsection if it is acquired either: (1) from a liquidation sale

of assets pursuant to a bankruptcy filed under Chapter 7 of the United States Bankruptcy Code; or (2) pursuant to a creditor's execution or foreclosure sale of a secured interest in the assets of the trade or business.

e. Example No. 1: Corporation X is doing business wholly outside of this state in the trade or business of manufacturing automobiles. The total fair market value of the total assets of this trade or business is \$100,000,000. Then, on or after January 1, 1994, Corporation X acquires all of the assets of an automobile manufacturing business in this state with a fair market of \$5,000,000 and immediately uses the acquired assets in its automobile manufacturing trade or business. Thereafter, between the date of acquisition and the last day of the month following the quarterly period during which the acquisition occurred, Corporation X acquires another \$1,000,000 in assets for use in the automobile manufacturing business in this state. Under these assumed facts, the conditions set forth in this subparagraph will not serve to disqualify Corporation X from the partial exemption since the fair market value of the acquired assets does not exceed 20 percent ($\$5,000,000/\$106,000,000$) of the aggregate fair market value of the total assets of the trade or business being conducted by Corporation X; and neither Corporation X nor any related person had conducted any trade or business activities in this state within the preceding 36 months.

f. Example No. 2: Assume the same facts as in Example No. 1 above, but in this case, prior to acquiring the assets of the automobile manufacturing business in this state, Corporation X was solely and exclusively in the trade or business of providing data processing services. After the acquisition of the assets by Corporation X, however, the acquired assets will continue to be used in the automobile manufacturing business in this state. Assume further that no additional purchases are made after the date of acquisition. Under these assumed facts, since data processing services and automobile manufacturing are classified in different divisions of the Manual, the partial exemption will not be available to Corporation X because the fair market value of the acquired assets exceeds 20 percent ($\$5,000,000/\$5,000,000$) of the aggregate fair market value of the total assets held by Corporation X in the same trade or business.

7. In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the person as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business. For purposes of this subsection only:

a. Example No. 1: Corporation X is doing business in this state. One of its trade or business activities in this state is manufacturing automobiles. After January 1, 1994, for consideration, Corporation X transfers all of the assets used in the trade or business of manufacturing automobiles to a newly-formed, wholly-owned subsidiary known as Corporation Y. For purposes of applying this regulation, this transaction shall be treated as an acquisition of an existing trade or business by Corporation Y.

b. Example No. 2: Partnership A is a manufacturer doing business in this state. After January 1, 1994, for consideration, Partnership A transfers all of its assets to a newly-formed

corporation known as Corporation B. Corporation B is owned by the partners of Partnership A in the same proportionate ownership interests as their respective ownership interests in the partnership. For purposes of applying this regulation, this transaction shall be treated as an acquisition of an existing trade or business by Corporation B.

8. For purposes of this subsection, a person is a "related person" if that person is or previously was related to the qualified person within the meaning of either section 267 or 318 of the Internal Revenue Code.

9. The term "acquire" shall include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(B) A qualified person must be engaged in those manufacturing lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition. For purposes of this subsection:

1. For purposes of classifying a line or lines of business, the economic unit shall be the "establishment" and the classification of the line or lines of business will be based on the establishment's single most predominant activity based upon value of production. The term "establishment" means an economic unit, generally at a single physical location, where business is conducted or where services or manufacturing or other industrial operations are performed. The following will generally constitute an "establishment": a factory, mill, store, hotel, movie theater, mine, farm, ranch, bank, railroad depot, airline terminal, sales office, warehouse, or central administrative office.

2. For purposes of determining the "establishment" or "establishments" of a trade or business:

a. Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports are prepared on the number of employees, their wages and salaries, sales or receipts, property and equipment, and other types of financial data, such as financial statements, job costing, and profit center accounting. For purposes of this paragraph, whether or not employment in an economic activity is significant shall be based upon all of the facts and circumstances. Nevertheless, employment in an economic activity will be considered to be "significant" for purposes of this paragraph whenever more than 25 percent of the taxpayer's total number of employees at a single physical location, or more than 25 percent of the taxpayer's total dollar value of payroll at a single physical location, is attributable to the economic activity being tested for separate establishment status.

b. An establishment is not necessarily identical with the enterprise or company which may consist of one or more establishments. Also, an establishment is to be distinguished from subunits of the establishment such as departments.

c. Where a person conducts business at more than one establishment within the meaning of this subsection, then that person shall be considered to be a "qualified person" for purposes of this regulation only as to those purchases that are intended to be used and are actually used in those lines of business that are described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.

(7) "Refining" means the process of converting a natural resource to an intermediate or finished product.

(8) "Research and development" means those activities that are described in section 174 of the Internal Revenue Code or in any regulations thereunder.

(9) "Tangible personal property" does not include any of the following:

(A) Real property, including tangible personal property to be incorporated into an improvement to real property, except for "special purpose buildings and foundations" as defined in subsection (c)(10)(D) and conveyance systems and assembly lines as provided in subsection (c)(10)(A).

(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E). Tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation.

(C) Furniture, inventory, equipment used in the extraction process, equipment used to store raw materials that have not yet entered or commenced the manufacturing process, or equipment used to store finished products that have completed the manufacturing process. The extraction process includes such severance activities as mining, oil and gas extraction.

(D) Any property for which a credit is claimed under either section 17053.49 or 23649 of the Revenue and Taxation Code.

(10) "Tangible personal property" includes but is not limited to the following:

(A) Machinery and equipment within the meaning of subsection (a)(6) of Regulation 1521 of the Sales and Use Tax Regulations, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. The term also includes conveyance systems and assembly lines without regard to the manner of affixation to real property.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall have a useful life of less than one year for purposes of this regulation.

(C) Property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state.

(D) Special purpose buildings and foundations that (i) are used as an integral part of the manufacturing, processing, refining, or fabricating process, or (ii) constitute a research facility used during the manufacturing process as an integral part of a manufacturing, processing, refining, or fabricating activity, or (iii) constitute a storage facility used during the manufacturing process as an integral part of a manufacturing, processing, refining, or fabricating activity. For purposes of this subsection:

1. For purposes of this subsection, "special purpose building and foundation" means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subsection (a)(1) of this regulation (the qualified purpose).

2. A building is specifically designed and constructed or modified for a qualified purpose if it is not economic to design and construct the building for the intended purpose and then use the structure for a different purpose.

3. A building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. "Incidental use" means a use which is both related and subordinate to the qualified purpose. A use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualifying purpose.

4. In the event an entire building does not qualify as a special purpose building, a taxpayer may establish that a portion of a building, and the foundation immediately underlying the portion, qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subsection.

5. Buildings and foundations that do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to, buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process.

6. For purposes of this subsection, the term "integral part" means that the special purpose building or foundation (i) is used directly in the activity qualifying for the partial exemption from sales and use tax and (ii) is essential to the completeness of that activity. In determining whether property is used as an integral part of manufacturing, all properties used by the qualified person in processing the raw materials into the final product are properties used as an integral part of manufacturing.

(E) Fuels used or consumed in the manufacturing process.

(F) Property used in recycling.

(11) "Standard Industrial Classification" means a Standard Industrial Classification in the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.

(d) Three-Year Limitation. Notwithstanding any other provision of this regulation, once a person has conducted business activities in a new trade or business for three or more years, that person will no longer be considered to be in a "new trade or business," nor "qualified" for this partial exemption.

(e) Taxes as to Which the Partial Exemption Does Not Apply. This partial exemption does not apply to any tax levied by a county, city, or district pursuant to, or in accordance with, either the Bradley-Burns Uniform Local Sales and Use Tax Law (Rev. & Tax. Code §§ 7200 et seq.) or the Transactions and Use Tax Law (Rev. & Tax Code §§ 7251 et seq.).

On or after January 1, 1995, this partial exemption shall not apply to any tax levied pursuant to section 6051.2 and 6201.2 of the Revenue and Taxation Code, or pursuant to section 35 of article XIII of the California Constitution.

(f) Exemption Certificates. Except as otherwise set forth in subsection (f)(3), to claim the partial exemption provided by this regulation, a person must be both pre-qualified by the Board and either registered to hold a seller's permit or maintain a consumer use tax account. Exemption certificates issued to qualified persons will contain a control number and expiration date for verifying a person's status as a qualified person. An exemption certificate is not valid if it has not been issued by the Board or if it is accepted after the expiration date on the certificate. Qualified persons who have been pre-qualified may reproduce the issued certificates as needed for their qualifying purchases.

The exemption certificates issued by the Board will be in substantially the same form as they appear in Appendices A and B of this regulation. Qualified persons who purchase or lease tangible personal property from an in-state retailer or an out-of-state retailer obligated to collect the use tax must provide the retailer with a manufacturer's exemption certificate in order to claim the partial exemption. The manufacturer's use tax declaration must be completed by a qualified person to claim a partial exemption from use tax on purchases of tangible personal property from an out-of-state retailer not obligated to collect the use tax.

(1) Manufacturer's Exemption Certificates.

(A) In General. Except as otherwise provided in subsections (f)(1)(B) or (f)(3) of this regulation, or in section 6902.2 of the Revenue and Taxation Code, a partial exemption from sales or use tax shall not be allowed unless:

1. The qualified person furnishes the retailer with a manufacturer's exemption certificate no later than 60 days after the date of the purchase; and
2. The retailer timely files a sales and use tax return claiming the partial exemption and, together with that timely return, provides the Board with a copy of the manufacturer's exemption certificate.

(B) Exclusions. Except as provided in subsection (f)(1)(C) below, retailers claiming the partial exemption in timely filed returns will not be required to furnish the Board with copies of manufacturer's exemption certificates for sales or leases of tangible personal property made by a retailer at any single physical location to a single qualified purchaser that do not exceed an aggregate total of \$25,000 during a single calendar quarter. Regardless of the total quarterly sales per purchaser, however, when necessary for the efficient administration of the sales and use tax law, the Board may, on 30 days' written notice, require a retailer to commence furnishing the Board with copies of all certificates on a quarterly basis pursuant to subsection (f)(1)(A)2.

(C) Retention And Availability Of Certificates. A retailer must retain each manufacturer's exemption certificate received from a qualified person for a period of four years from the date on which the retailer claims a partial exemption based on the exemption certificate.

Within 45 days of the Board's request, retailers must furnish to the Board any and all manufacturer's exemption certificates, or copies thereof, received from qualified persons, including exemption certificates for aggregate sales or leases of \$25,000 or less to a single qualified person made at any single physical location of the retailer during a single calendar quarter.

(2) Manufacturer's Use Tax Declaration. Except as provided in section 6902.2 of the Revenue and Taxation Code, a partial exemption from the use tax shall not be allowed unless the qualified person:

(A) Timely files a sales and use tax return or consumer use tax return for the period in which the purchase occurs and timely pays any applicable tax in full that is excluded from this partial exemption as provided in subsection (e) of this regulation; and

(B) Attaches a completed manufacturer's use tax declaration to the sales and use tax return or consumer use tax return that is timely filed with the Board.

(3) ~~Waiver-Refund of Partial Exemption.—Except as specifically set forth in section 6902.2 of the Revenue and Taxation Code:~~

~~—(A) Failure to claim the partial exemption by furnishing the retailer with a manufacturer's exemption certificate within 60 days after an otherwise qualified purchase constitutes a waiver of the partial exemption for that purchase and, as a consequence, the partial exemption cannot be claimed on that purchase.~~

~~—(B) Failure to file a timely return for an otherwise qualified purchase from a retailer not engaged in business in this state, or failure to attach a completed manufacturer's declaration to such a timely filed return, does not constitute a waiver of the use tax partial exemption for that purchase. A person who fails to file a timely return or attach a completed manufacturer's declaration to a timely return for an otherwise qualified purchase has the burden of establishing that he or she was entitled to claim the partial exemption.~~

(A) For the period commencing on January 1, 1994, and ending on December 31, 1994, a qualified person may claim the partial exemption on qualified purchases from an in-state retailer or an out-of-state retailer obligated to collect the use tax by furnishing the retailer with a manufacturer's exemption certificate on or before March 31, 1995. The retailer must refund the tax directly to the purchaser or, at the purchaser's sole option, the purchaser may be credited with such amount. In the event that the retailer has already reported and paid the tax to the Board, the retailer must file a written claim for refund on or before April 30, 1995.

~~(B)~~ A person who self-reported and paid sales tax on a qualified sale or paid use tax on a qualified purchase from a retailer not engaged in business in this state, and who failed to claim the partial ~~use tax~~ exemption as provided by this regulation may file a claim for refund equal to the amount of the partial exemption that he or she could have claimed pursuant to this regulation. The procedure for such a claim shall be the same as for other claims for refund filed pursuant to Revenue and Taxation Code section 6901. For transactions subject to use tax, ~~A~~ a person filing a claim for refund of the partial ~~use tax~~ exemption has the burden of establishing that he or she was entitled to claim the partial exemption with respect to the amount of refund claimed under this part. For transactions subject to sales tax, a person filing a claim for refund of the partial exemption has the burden of establishing that the purchaser of the qualified property otherwise met all the requirements of a qualified person at the time of the purchase subject to the refund claimed under this part.

(4) Construction Contractors. In the case of a contractor who purchases property as an agent of a qualified person or for subsequent resale to a qualified person, the qualified person is deemed to be the purchaser for purposes of this subsection.

(g) Conversion of Property to a Use Not Qualifying for the Partial Exemption. Notwithstanding subsection (a), this partial exemption shall not apply to any sale of, or the storage, use, or other consumption in this state of property that, within one year from the later of the date of purchase of the property or the date that the property was first placed into service by the purchaser in an exempt use, is: (i) removed from this state, (ii) converted from an exempt use under this regulation to some other use not qualifying for the partial exemption, or (iii) used in a manner not qualifying for the partial exemption under this regulation. For purposes of this subsection, property is converted to a use not qualifying for the partial exemption if, without limitation, the property, or any interest in the property, or possession or control of the property, is either directly or indirectly sold, transferred, leased, or assigned to a person who is not a qualified person on the date the property is sold, transferred, leased, or assigned to such nonqualified person. In the case of a corporation that, as a qualified person, purchases tangible personal property under this partial exemption and then, within one year from the later of the date of purchase of the property or the date that the property was first placed into service by that corporation in an exempt use, either directly or indirectly transfers that property to its parent corporation that is not a qualified person on the date of the transfer of property to the parent corporation, that property has been converted to a use not qualifying for the partial exemption.

(h) Purchaser's Liability for the Payment of Sales Tax. If a purchaser submits a copy of a manufacturer's exemption certificate to the seller, and then within one year from the later of the date of purchase of the property or the date that the property was first placed into service by the purchaser in an exempt use, the purchaser either (i) removes that property from this state, (ii) converts that property from an exempt use under this regulation to some other use not qualifying for the partial exemption, or (iii) uses that property in a manner not qualifying for the partial exemption under this regulation, then, in that event, the purchaser shall be liable for payment of sales tax, with applicable interest, to the same extent as if the purchaser were a retailer making a retail sale of the property at the time the property was so removed, converted, or used; and the sales price of the property to the purchaser shall be deemed to be the gross receipts from that retail sale. For purposes of this subsection, property is converted to a use not qualifying for the partial exemption if, without limitation, the property, or any interest in the property, or possession or control of the property, is either directly or indirectly sold, transferred, leased, or assigned to a person who is not a qualified person on the date the property is sold, transferred, leased, or assigned to such nonqualified person.

(i) Leases to Qualifying Persons.

(1) Leases--In General. Subject to all the limitations and conditions set forth in this regulation and regulation 1525.3, this partial exemption may apply to rental receipts paid by a qualified person with respect to a lease of tangible personal property to the qualified person, which tangible personal property is used as set forth in subsections (a)(1), (a)(2), (a)(3), or (a)(4) of this regulation.

(2) Leases--Acquisition Sale and Leaseback. A person will be regarded as having paid sales tax reimbursement or use tax with respect to that person's purchase of property, within the meaning of those words as they are used in section 6010.65 of the Revenue and Taxation Code, if the person has paid all applicable taxes with respect to the acquisition of the property, notwithstanding the fact that the sale and purchase of the property may have been subject to the partial exemption from tax provided by this regulation.

(3) Subsequent Lease of Property Acquired Subject to Partial Exemption. If a person has acquired property subject to the partial exemption provided by this regulation and has paid all applicable taxes at that acquisition, the property will be regarded as property as to which sales tax reimbursement or use tax has been paid, and the subsequent lease of that property will not be subject to tax measured by rental receipts.

(j) Effective Date. Except as expressly set forth otherwise in subsections (c)(6)(A)6. and (e) of this regulation, this regulation is effective as of January 1, 1994.

Authority: Section 7051, revenue and Taxation Code
Reference: Section 6377, Revenue and Taxation Code.

Regulation 1525.2
SECTION 6377 MANUFACTURER'S EXEMPTION CERTIFICATE

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LS: 11-17-99, 2-18-00

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

PLEASE NOTE

This is a partial exemption from sales and use tax at the rate of 5% effective January 1, 1995. You are not relieved from your obligations for the local and district taxes on this transaction. The exemption is specific to this transaction only and may not be construed to exempt other transactions. Generally, the partial exemption will not be allowed unless this certificate is issued within 60 days after the date of purchase and the retailer claims the exemption on a timely filed return. Void after expiration date.

Certificate No:

Expires:

I hereby certify that the tangible personal property described below and purchased or leased from: (enter seller's/lessor's name and address)

SELLER'S NAME

SELLER'S ADDRESS (Street, City, State, Zip Code)

and will be used by me primarily (please check one)

1. for manufacturing, processing, refining, fabricating, or recycling, or
2. for research and development activities as described in Internal Revenue Code Section 174, or
3. to maintain, repair, measure, or test any property being used for (1) or (2) above, at my facility located at (enter facility's address):
(Street, City, State, Zip Code)

CERTIFICATE NOT VALID FOR PURCHASES WITH A UNIT VALUE OF \$250.00 OR LESS

SALES INVOICE NUMBER	SALES INVOICE DATE	DESCRIPTION OF QUALIFIED PROPERTY PURCHASED OR LEASED*	SALES PRICE/ RENTALS PAYABLE

I understand that if such property is, within one year from the date of purchase or lease, removed from California or converted for use or otherwise used in a manner not qualifying for the exemption that I am required by the Sales and Use Tax Law to report and pay the state tax measured by the sales price/rentals payable of the property to/by me. *Attach a copy of the lease agreement.

PRINT NAME	TITLE
SIGNATURE	DATE PERMIT NUMBER

NOT VALID UNLESS COMPLETED BY THE CALIFORNIA STATE BOARD OF EQUALIZATION

The following business has been registered as a "qualified person" who has certified that this purchase/lease of tangible personal property will be used in a manner entitling them to the exemption provided in Section 6377 of the Revenue and Taxation Code.

BUSINESS NAME	SIC CODE	
BUSINESS ADDRESS (Street, City, State, Zip Code)		PERMIT NUMBER

AUTHORIZED BY (Must Have Two Signatures)

REVIEWED BY	DATE
APPROVED BY	DATE

THIS FORM MAY BE REPRODUCED
Appendix A

Regulation 1525.2
SECTION 6377 MANUFACTURER'S USE TAX DECLARATION

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LS: 11-17-99, 2-18-00
STATE OF CALIFORNIA
BOARD OF EQUALIZATION

PLEASE NOTE

This exemption being declared applies only to the state use tax which is at the rate of 5% effective January 1, 1995 and is specific to this transaction only and may not be construed to exempt other transactions. As the purchaser, you remain liable for the applicable local and district taxes. To claim the exemption, this declaration must accompany a timely filed sales and use tax.

Certificate No:

Expires:

I hereby certify that the tangible personal property described below that is subject to use tax was purchased or is being leased from: (enter seller's/lessor's name and address)

SELLER'S NAME

SELLER'S ADDRESS (Street, City, State, Zip Code)

and will be used by me primarily (please check one)

1. for manufacturing, processing, refining, fabricating, or recycling, or
2. for research and development activities as described in Internal Revenue Code Section 174, or
3. to maintain, repair, measure, or test any property being used for (1) or (2) above, at my facility located

at (enter facility's

address):

(Street, City, State, Zip Code)

CERTIFICATE NOT VALID FOR PURCHASES WITH A UNIT VALUE OF \$250.00 OR LESS.

SALES INVOICE NUMBER	SALES INVOICE DATE	DESCRIPTION OF PROPERTY PURCHASED OR LEASED*	SALES PRICE/ RENTALS PAYABLE

I understand that if such property is, within one year from the date of purchase or lease, removed from California or converted for use or otherwise used in a manner not qualifying for the exemption that I am required by the Sales and Use Tax Law to report and pay the state tax measured by the sales price/rentals payable of the property to/by me. *Attach a copy of the lease agreement.

PRINT NAME	TITLE
SIGNATURE	DATE
	PERMIT NUMBER

NOT VALID UNLESS COMPLETED BY THE CALIFORNIA STATE BOARD OF EQUALIZATION

The following business has been registered as a "qualified person" who has certified that this purchase/lease of tangible personal property will be used in a manner entitling them to the exemption provided in Section 6377 of the Revenue and Taxation Code.

BUSINESS NAME	SIC CODE	
BUSINESS ADDRESS (Street, City, State, Zip Code)		PERMIT NUMBER

AUTHORIZED BY (Must Have Two Signatures):

REVIEWED BY	DATE
APPROVED BY	DATE

THIS FORM MAY BE REPRODUCED
Appendix B

April 25, 2000 Submission from Ernst & Young

Suggested Amendments to Regulation 1525.2

Ernst & Young submitted suggested amendments to the regulation last year which we would like to modify at this time. The attached amendments solely address the issue of qualified property fully expensed for income tax purposes in the year of acquisition. We believe the existing requirement in the regulation that an item must be capitalized for income tax purposes is not supported by the statute. Equipment, repair, and replacement parts that do not meet the capitalization criteria for state income tax purposes or financial accounting purposes frequently have a useful life of more than one year. We see no statutory reason for making a distinction between property expensed in one year versus two or more years.

Our suggested language recognizes that frequently situations occur where items with a useful life of more than one year are expensed for financial and tax reporting purposes. It is not practical to account for all property acquired as an asset even if the useful life may exceed one year. Our proposal retains the general rule regarding the income tax treatment of the property, yet we believe it is fair and appropriate to allow taxpayers the opportunity to rebut this presumption by submitting evidence to establish a useful life of more than one year.

Revenue and Taxation Code section 6377 exempts from the five percent (5%) state tax (but not local or transaction tax) the sale and use of tangible personal property used in certain manufacturing and related activities. The statute includes within the definition of tangible personal property:

“All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or components parts are assembled by the taxpayer or another party.” (Rev. & Tax Code § 6377 (b)(11)(B).)

California state law section § 24343 states that section § 162 of the Internal Revenue Code, relating to trade or business expenses, shall apply, except as otherwise provided. Federal regulations define qualified repair expense for income tax purposes:

“The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer’s plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to

April 25, 2000 Submission from Ernst & Young

the extent that they arrest deterioration and appreciably prolong the life of the property, shall either be capitalized and depreciated in accordance with section 167 or charged against the depreciation reserve if such an account is kept. [Reg. § 1.162-4.]

We therefore have an apparent conflict between the income tax rule and the rule established in Regulation 1525.2. The federal regulation allows for capitalization of an item if the property “arrest deterioration and appreciably prolong the life.” It does not place as a requirement that the item must have a useful life of less than one year to be expensed for income tax purposes in the year of acquisition. It rather focuses on whether the repair parts materially add value to the property or appreciably prolong its life, or just maintain an ordinary efficient operating condition.

Many large taxpayers have a very material threshold for the capitalization of tangible personal property. It is not uncommon to set the threshold at an amount of \$3,000 or more. The cost of accounting for an asset for the life of the equipment can easily exceed a threshold as low as \$250. An asset that is capitalized must be “tagged”, tracked, counted in annual inventories, depreciated on the books, and ultimately disposed. Our proposal recognizes the economic reality that large companies face.

We also believe that the rebutting of the presumption will not create chaos between the state and taxpayers. If you replace a part of buy a new item used in the manufacturing process very two and a half years, then the property obviously has a useful life of more than one year. Manufacturers, industry groups, and tax tables also rate the useful lives of property. Common sense in most cases will make this an easy call.

We wish to thank the Board for the opportunity to once again discuss this important industry issue.

April 25, 2000 Submission from Ernst & Young

[1525.2 (c) Definitions.]

(9) “Tangible personal property” does not include any of the following:

(A) Real property, including tangible personal property to be incorporated into an improvement to real property, except for “special purpose buildings and foundations” as defined in subsection (c)(10)(D) and conveyance systems and assembly lines as provided in subsection (c)(10)(A).

(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E). For purposes of this regulation, it shall be presumed that tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation. This presumption may be rebutted by evidence satisfactory to the board.

(C) Furniture, inventory, equipment used in the extraction process, equipment used to store raw materials that have not yet entered or commenced the manufacturing process, or equipment used to store finished products that have completed the manufacturing process. The extraction process includes such severance activities as mining, oil and gas extraction.

(D) Any property for which a credit is claimed under either section 17053.49 or 23649 of the Revenue and Taxation Code.

(10) “Tangible personal property” includes but is not limited to the following:

(A) Machinery and equipment within the meaning of subsection (a)(6) of Regulation 1521 of the Sales and Use Tax Regulations, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. The term also includes conveyance systems and assembly lines without regard to the manner of affixation to real property.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall be presumed to have a useful life of less than one year for purposes of this regulation. This presumption may be rebutted by evidence satisfactory to the board.

(C) Property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state.

Regulation 1525.2, Manufacturing Equipment
Comparison of Current and Proposed Language
 Current as of May 18, 2000

Current Regulatory Language (Recommended by Staff)	Regulatory Language Proposed by Industry 1 (Manufacturers)	Regulatory Language Proposed by Industry 2 (Retailers)	Summary Comments
<p>1525.2 (c) Definitions.</p> <p>(9) "Tangible personal property" does not include any of the following:</p> <p>(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E). Tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation.</p>	<p>1525.2 (c) Definitions.</p> <p>(9) "Tangible personal property" does not include any of the following:</p> <p>(B) Consumables with a normal useful life of less than one year, except as provided in subsection (c)(10)(E). <u>For purposes of this regulation, it shall be presumed t</u>Tangible personal property that the qualified person treats as having a normal useful life of less than one year for state income or franchise tax purposes or tangible personal property which is acquired by the qualified person at a unit cost of \$250 or less is tangible personal property with a normal useful life of less than one year for purposes of this regulation. <u>This presumption may be rebutted by evidence satisfactory to the board.</u></p>	<p>1525.2 (c) Definitions.</p> <p>[No change from current regulatory language]</p> <p>[No change from current regulatory language]</p>	<p>Industry 1 proposes to amend subsections (c)(9)(B) and (c)(10)(B) to provide a rebuttable presumption regarding the provisions that classify an item as a consumable item that does not qualify for the partial tax exemption. It is their belief that the existing requirement that an item must be capitalized for income tax purposes is not supported by the statute.</p> <p>Industry 2 favors no change to these provisions, in line with concerns expressed by retailers about the undue burden placed on them if exemption certificates are allowed to be issued for small items.</p> <p>Staff recommends no change to current regulatory language, believing the current guidelines to be fair, clear and unambiguous.</p>

Regulation 1525.2, Manufacturing Equipment
Comparison of Current and Proposed Language
 Current as of May 18, 2000

Current Regulatory Language (Recommended by Staff)	Regulatory Language Proposed by Industry 1 (Manufacturers)	Regulatory Language Proposed by Industry 2 (Retailers)	Summary Comments
<p>1525.2 (c) Definitions.</p> <p>(10) "Tangible personal property" includes but is not limited to the following:</p> <p>(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall have a useful life of less than one year for purposes of this regulation.</p>	<p>1525.2 (c) Definitions.</p> <p>(10) "Tangible personal property" includes but is not limited to the following:</p> <p>(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, including both operating programs and application programs, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party. Any repair and replacement parts that the qualified person treats as having a useful life of less than one year for state income or franchise tax purposes shall <u>be presumed to have a useful life of less than one year for purposes of this regulation. This presumption may be rebutted by evidence satisfactory to the board.</u></p>	<p>1525.2 (c) Definitions.</p> <p>[No change from current regulatory language]</p> <p>[No change from current regulatory language]</p>	